

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;  
Nanci E. Langley, Vice Chairman;  
Mark Acton;  
Tony Hammond; and  
Robert G. Taub

Institutional Cost Contribution  
Requirement for Competitive Products

Docket No. RM2012-3

ORDER REVIEWING COMPETITIVE PRODUCTS' APPROPRIATE SHARE  
CONTRIBUTION TO INSTITUTIONAL COSTS

(Issued August 23, 2012)

I. INTRODUCTION

The Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006), directs the Commission to promulgate a regulation to ensure that competitive products, collectively, bear an “appropriate share” of the Postal Service’s institutional costs. See 39 U.S.C. 3633(a)(3). That regulation is found at 39 CFR 3015.7(c). The Commission is required to review its appropriate share regulation at least every 5 years. 39 U.S.C. 3633(b). In this docket, the Commission conducts its first review of that regulation and considers whether it should be modified.<sup>1</sup> As

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<sup>1</sup> Order No. 1108, Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, January 6, 2012 (Notice).

discussed below, the Commission finds that the appropriate share regulation should be retained in its current form.

First, the Commission reviews the procedural history of this proceeding. Second, the Commission examines the comments filed by interested parties and other information provided in connection with this proceeding. Third, the Commission reviews the analysis undertaken in its initial appropriate share determination. Finally, the Commission conducts the appropriate share analysis required under 39 U.S.C. 3633(b).

## II. PROCEDURAL HISTORY

On January 6, 2012, the Commission initiated this docket and provided notice and an opportunity for interested persons to comment on whether its current regulation regarding the appropriate share of competitive products' contribution to institutional costs should be retained or modified. Notice at 14. Initial comments were due on March 5, 2012, and reply comments were due on April 2, 2012.

On February 24, 2012, Parcel Shippers Association (PSA) filed a motion to extend the due dates for initial and reply comments for 11 months.<sup>2</sup> PSA argued that the delay would be appropriate due to uncertainty regarding the Postal Service and Congressional action. *Id.* at 1-7.<sup>3</sup> The Commission granted the motion, in part, extending the comment deadline for approximately 1 month, revising the deadline for initial comments to April 9, 2012, and reply comments to May 7, 2012.<sup>4</sup> In determining that a further extension was unwarranted, the Commission found that 39 U.S.C. 3633

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<sup>2</sup> Motion of the Parcel Shippers Association to Extend the Period for Preparing Initial and Revised Comments, February 24, 2012 (PSA Motion).

<sup>3</sup> Several parties filed statements supporting the PSA Motion. See Answer of the United States Postal Service to Parcel Shippers Association Motion, March 2, 2012; Comments of the Association for Postal Commerce in Support of the Motion of the Parcel Shippers Association for Changes in the Procedural Schedule, February 29, 2012; Public Representative Comments on Parcel Shippers Association Motion to Extend Initial and Reply Comment Period, February 29, 2012; Comments of the Direct Marketing Association, Inc. in Support of the Parcel Shippers Association Motion for Changes in Procedural Schedule, February 28, 2012.

<sup>4</sup> Order Granting, In Part, Motion of the Parcel Shippers Association to Extend the Period for Comments, March 7, 2012 (Order No. 1276).

requires it to review the appropriate share contribution every 5 years. Order No. 1276 at 3. It also found that the statute provides the Commission with additional authority to review the contribution level more often than every 5 years, if relevant circumstances materialize, which could include those discussed in the PSA Motion. *Id.* at 3-4.

Initial comments were filed by PSA, United Parcel Service (UPS), the Postal Service, the Public Representative, and William C. Miller.<sup>5</sup> Reply comments were filed by PSA, UPS, the Postal Service, and the Public Representative.<sup>6</sup> On May 16, 2012, Chairman's Information Request No. 1 (CHIR No. 1) was issued.<sup>7</sup> The Postal Service filed its response to CHIR No. 1 on May 23, 2012.<sup>8</sup>

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<sup>5</sup> Comments of the Parcel Shippers Association, April 9, 2012 (PSA Comments); Initial Comments of United Parcel Service on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, April 9, 2012 (UPS Comments); Comments of the Public Representative in Response to Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, April 9, 2012 (PR Comments); Initial Comments of the United States Postal Service on Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, April 10, 2012 (Postal Service Comments); Comments by William C. Miller in Response to the Postal Regulatory Commission's Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, April 10, 2012 (Miller Comments). Both the Postal Service and Miller filed motions for late acceptance of their comments. Motion of the United States Postal Service for Late Acceptance of Filing of Initial Comments, April 10, 2012; Motion for Late Acceptance of Initial Comments, April 10, 2012. These motions are granted.

<sup>6</sup> Reply Comments of the Parcel Shippers Association, May 7, 2012 (PSA Reply Comments); Reply Comments of United Parcel Service on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, May 7, 2012 (UPS Reply Comments); Reply Comments of the United States Postal Service, May 7, 2012 (Postal Service Reply Comments); Reply Comments of Public Representative, May 7, 2012 (PR Reply Comments).

<sup>7</sup> Chairman's Information Request No. 1, May 16, 2012.

<sup>8</sup> Response of the United States Postal Service to Chairman's Information Request No. 1, May 23, 2012 (Response to CHIR No. 1).

### III. COMMENTS AND ADDITIONAL INFORMATION

#### A. Initial Comments

Initial comments can be grouped into three categories. UPS argues that the current appropriate share contribution level should be changed. PSA, the Postal Service, and the Public Representative argue that the current appropriate share contribution level should be retained. Miller believes that the current appropriate share contribution level should be eliminated. Each party's arguments are discussed in more detail below.

*UPS.* UPS believes that a change in the contribution level is "clearly needed." UPS Comments at 1. It argues that this proceeding is important for the following four reasons: (1) the appropriate share requirement is a major competitive safeguard established by the PAEA; (2) institutional costs are increasing compared to attributable costs; (3) the next appropriate share review under 39 U.S.C. 3633(b) is not scheduled to begin until 2017; and (4) the current approach is not compatible with the Postal Service's changing business model. *Id.* at 2-3. UPS asserts that the rapid and substantial decline in First-Class Mail volume and revenue, the growth in competitive revenue from increased e-commerce goods delivery, and the substantial ongoing transfers of formerly market dominant products to the competitive category undercut the Commission's current static approach. *Id.* at 7. UPS contends that a static approach implies that products transferred to the competitive product list need not contribute toward institutional costs if revenues from previously-existing products currently meet the 5.5 percent appropriate share requirement. Moreover, such a problem cannot be addressed until the next appropriate share review. UPS contends that the current static contribution level is out of step with the competitive products growing share of revenue and attributable costs, which are metrics often used by businesses to allocate overhead costs. *Id.* at 8-9.

UPS also points out that "[d]espite a widespread assumption to the contrary, competitive revenue in excess of the mandated 'appropriate share' and imputed tax"

has not typically gone toward institutional costs. *Id.* at 4 n.3. UPS believes that the low, fixed contribution level was likely implemented to ease the Postal Service's transition under the PAEA, and that consideration is now far less relevant. It notes that the PAEA has been in effect for approximately 5 years and competitive products have demonstrated an ability to generate greater contribution under the PAEA's statutory framework. *Id.* at 9.<sup>9</sup>

Accordingly, UPS recommends that the Commission adopt an approach that self-corrects for changes in the relative size of the two product categories – the market dominant and the competitive products. *Id.* UPS contends that there are a number of variable, self-adjusting contribution approaches that would ensure competitive products' contribution levels are more proportional to their use of the Postal Service's integrated infrastructure. It asserts that the Commission should require the Postal Service to use competitive revenue to help make up for market dominant products' decreasing contributions. *Id.* at 10.<sup>10</sup> UPS recognizes that changes in methodology may necessitate a transition period and suggests that a phase-in approach for a new methodology might be appropriate. *Id.*

*PSA.* PSA recommends that the Commission make no change to the appropriate share requirement at the current time. PSA Comments at 1. It asserts that the Commission successfully balanced the applicable risks when it initially established the minimum contribution level at 5.5 percent. *Id.* at 2. It believes that there is no urgency requiring the Commission to change the appropriate share level at the current time since the Postal Service does not appear to be underpricing its competitive products to gain market share. *Id.*

It also contends that the passage of time will eliminate some uncertainty regarding the Postal Service and its financial situation. *Id.* According to PSA, these

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<sup>9</sup> UPS observes that there is currently over \$1 billion in the Competitive Products Fund. *Id.*

<sup>10</sup> As examples, UPS directs the Commission to approaches that could be based on a cost or burden, such as equal cost coverages, or a market based approach, such as percentage share of revenue. *Id.*

uncertainties include: (1) the effect of the Postal Service's proposed mail processing network changes on attributable and institutional costs; (2) significant and ongoing changes in the mail mix; (3) the postponement or failure to make retiree health benefit and other statutorily required payments; (4) the impact of the recent transfer of products to the competitive product list and potential additional transfers in the near future; and (5) the business model changes being sought by the Postal Service. *Id.* at 2-3. When more is known about how these circumstances will "play out and how they affect the relative amounts and shares of institutional costs borne by competitive and market products," PSA asserts that it may be appropriate to adjust the contribution level. *Id.* at 3. With the Commission's assurance that it may revisit the appropriate share requirement at any time in the future, PSA believes that now is not an appropriate time to change the existing requirement. *Id.* at 4.

*Postal Service.* The Postal Service recommends that the Commission maintain the current requirement that the Postal Service's competitive products cover 5.5 percent of institutional costs, but add a new provision that allows the Commission to determine, on a case-by-case basis, that a contribution below 5.5 percent meets the appropriate share requirement. Postal Service Comments at 1. The Postal Service believes that the Commission should retain its current method because it best comports with the statute, it is simply measured, parties have become accustomed to it, and changing it could unnecessarily disrupt the Postal Service's pricing strategies and make it difficult to compare results in coming fiscal years to prior years. *Id.* at 3. The Postal Service also asks the Commission to be mindful of both the interest in not setting the level so high as to constrain the Postal Service's flexibility, and the interest in preserving competition by not setting the level so low as to give the Postal Service an artificial competitive advantage.

The Postal Service's comments include a table on competitive contribution during the previous 5 years. *Id.* at 5. It believes that this shows that the 5.5 percent level is not so low as to give it an artificial competitive advantage. The Postal Service also submits a market share analysis showing that its market share for its Express Mail

product has increased slightly both in terms of revenue and volume over the past 5 years. *Id.* at 6-7. Its analysis also shows that its share of the combined domestic 2/3 day air and ground delivery market (including Priority Mail, Parcel Post, Parcel Select, and Parcel Return Service) has remained unchanged in terms of volume and increased slightly in terms of revenue over the same period. *Id.* at 6-7.

The Postal Service believes that factors outside its control weigh in favor of lowering the 5.5 percent contribution level although it asserts that recent transfers of products to the competitive product list weigh against a significant reduction. *Id.* at 9. The Postal Service believes that the 5.5 percent level is too high to properly be considered a floor. However, it concedes that the 5.5 percent level has not had a detrimental effect on it. *Id.* at 8-9. The Postal Service notes that it is difficult to predetermine a regulatory floor with future conditions yet unknown. Accordingly, the Postal Service endorses maintaining 5.5 percent as the appropriate share as long as the Commission provides itself with the authority to find, on a case-by-case basis, that a contribution below 5.5 percent may be “appropriate” based on the circumstances at the time of any shortfall.

*Public Representative.* The Public Representative contends that the 5.5 percent appropriate share level should be maintained at the current time, as long as the Commission reserves the right to institute another review prior to the next mandatory 5 year review. *Id.* at 5-6. In support of his view, he includes a table showing the Postal Service’s competitive products contribution during the previous 5 years including an adjustment for deferrals of mandatory Retiree Health Benefit Fund (RHFB) payments. *Id.* at 2. The Public Representative notes that even taking those deferrals into account, competitive products have still met or exceeded 5.5 percent. *Id.* He believes that while the internet and changes in advertising resources have taken a toll on the two largest market dominant products, the internet has also been a primary driver of recent volume and revenue increases in the parcel dominated competitive products. *Id.* at 3.

Additionally, he notes that the recent transfer of some First-Class Mail parcels and Standard Mail Parcels has increased the volume of competitive products by almost

50 percent and increased revenues by almost 20 percent. *Id.* He contends that little is known about the effects that these transfers will have on the cost of competitive products or on their contribution to institutional costs. *Id.* at 4. The Public Representative asserts that the uncertainty regarding proposed changes to the Postal Service's network, delivery frequency, employee benefits, and Congressional legislation could also have a profound effect on the current cost structure and pool of institutional costs. *Id.* at 5. He believes that until these questions are answered, it would be premature to recommend any changes to the competitive products' appropriate share contribution to institutional costs. *Id.*

*William C. Miller.* Miller believes that the Commission should eliminate the appropriate share requirement. Miller Comments at 2, 15. Relying on economic theory, Miller shows that a profit maximizing firm would generate the maximum possible contribution to institutional costs. *Id.* at 14. Therefore, his analysis contends that, under a profit maximizing strategy, the Postal Service would exceed any contribution requirement if it is capable of doing so. *Id.* On the other hand, he asserts that if the contribution requirement is set too high, a profit maximizing firm would be unable to comply since it would have already extracted the maximum profit possible. *Id.* at 15. As an alternative to eliminating the appropriate share provision, Miller recommends that the Commission consider conducting its own independent analysis of the maximum contribution possible from competitive products and set the institutional funding level as a goal instead of a requirement. *Id.*

## B. Reply Comments

Reply comments were filed by PSA, UPS, the Postal Service, and the Public Representative. They address the Postal Service's suggestion of the introduction of a case-by-case appropriate share analysis, UPS' self-adjusting approach, and Miller's proposal to eliminate the appropriate share requirement. Each party's reply comments are discussed in more detail below.

*PSA.* PSA does not support the Postal Service's suggestion that the Commission grant itself the authority to find, on a case-by-case basis, that an institutional cost contribution from competitive products below 5.5 percent is appropriate based on the totality of the circumstances. PSA Reply Comments at 2. It believes that the annual compliance review process is already burdened by the breadth of the required review and the statutory limits on its duration. *Id.* PSA views the appropriate share requirement as a major safeguard that helps separate essentially monopoly activities from competitive ones. *Id.* at 3. While PSA agrees that relevant circumstances may warrant future recognition that a change in the requirement is appropriate, it believes this should be done in a separate rulemaking that would allow all interested parties full opportunity to comment, rather than as a part of the annual compliance review process. *Id.* PSA also welcomes future discussion of UPS' suggestions, but does not believe this is an appropriate time to consider them because of the uncertainties discussed in its initial comments. *Id.* at 4.

*UPS.* UPS contends that other commenters' reasoning is based on the faulty assumption that all competitive revenues after payment of attributable costs are treated as contributions to institutional costs. UPS Reply Comments at 2. Competitive products' actual contributions to institutional costs have not exceeded 5.5 percent of the Postal Service's institutional costs. Instead, the Postal Service has transferred exactly 5.5 percent (plus the imputed tax payment), and the remainder of the available contribution has remained in the Competitive Products Fund. *Id.* at 2-3. Additionally, UPS believes that retaining the 5.5 percent appropriate share contribution will not properly address the Postal Service's broken business model or reflect competitive products' increased use of the postal network. *Id.* at 4-5. Rather, it advocates for a self-adjusting approach. *Id.*

UPS also argues against Miller's approach since it believes that the appropriate share requirement is intended to fairly allocate the burden of the use of the postal

system between the market dominant and competitive products. *Id.* at 6-7.<sup>11</sup> UPS also advocates rejecting the Postal Service's proposal to allow competitive products to contribute less than 5.5 percent toward institutional costs on a case-by-case basis. First, UPS questions the legality of this approach. *Id.* at 7. Second, it notes that the Commission may commence a proceeding, similar to this one, to change the methodology if circumstances warrant. *Id.* at 7-8.

*Postal Service.* The Postal Service believes that UPS “conflates the issue of whether the current method<sup>[12]</sup> best reflects the section 3633(a)(3) directive with the separate, distinct issue of whether the current institutional cost share level of 5.5 percent is appropriate.” Postal Service Reply Comments at 2. The Postal Service also argues that UPS's self-correcting approach is unnecessary since, if circumstances change, the Commission can alter its approach at any time. *Id.* at 3. Additionally, the Postal Service criticizes UPS for not submitting a more detailed alternative. *Id.*

The Postal Service also points out that while it agrees with PSA's and the Public Representative's conclusion to keep the current institutional cost share level at 5.5 percent, it believes that the rationale it provides in its initial comments is a stronger basis for reaching the parties' shared conclusion. Finally, the Postal Service states that it agrees with Miller's comments in a general sense, but believes that the appropriate share requirement serves the purpose of assuring other parties that the Postal Service will not shift away from its contribution-maximizing approach.

*Public Representative.* The Public Representative argues that competitive product volumes and revenues are not the only parameters to be taken into consideration when evaluating the appropriate share contribution from competitive

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<sup>11</sup> UPS also asserts that Miller's argument is undercut by the fact that more than \$1 billion is currently in the Competitive Products Fund. *Id.*

<sup>12</sup> The Commission does not consider its current approach to determining the appropriate share contribution requirement to be a methodology. Rather, the Commission determined the current static 5.5 percent minimum based on the fact that the Postal Service is no longer subject to many of the pricing constraints of the Postal Reorganization Act (PRA) and the fact that the Postal Service should be able to perform as well as it had historically under the PRA. *See infra* section IV.

products. PR Reply Comments at 2. Additionally, the Public Representative contends that even if the Commission wanted to establish a variable, self-adjusting mechanism as advocated by UPS, it is unclear what methodology UPS is advancing. *Id.* at 3. The Public Representative asserts that without a clear understanding of exactly what UPS is advocating, it is difficult to properly evaluate this approach. *Id.* at 4.

The Public Representative also believes that the Postal Service's proposed rule modification "should not be regarded lightly." *Id.* He contends that "the Commission should take note that any circumstance that would cause competitive products to not reach the 5.5 percent contribution threshold can be readily and quickly remedied by the Postal Service." *Id.* The Public Representative explains that the Postal Service has significantly more flexibility in changing competitive product prices than it does for market dominant products and thus, absent any unforeseen event in the last month of the relevant fiscal year, should be able to ensure compliance with section 3633(a)(3). *Id.*

#### C. Response to CHIR No. 1

CHIR No. 1 was issued to determine the amounts that have actually been transferred from the Competitive Products Fund to the Postal Service Fund to pay for institutional costs. CHIR No. 1 at 1-2. The Postal Service response effectively confirms that it has contributed 5.5 percent of institutional costs plus the calculated imputed tax payment on an annual basis. Response to CHIR No. at 1-2. It explains that assets in the Competitive Products Fund are not "trapped," and can be used for a variety of purposes, and that its current financial projections assume all Competitive Products Fund assets may be liquidated. *Id.*

#### IV. INITIAL APPROPRIATE SHARE ANALYSIS

It is helpful to review the Commission's analysis from its initial appropriate share contribution review. In setting the initial appropriate share contribution in Docket No. RM2007-1, the Commission considered various options including "equal unit

contribution, equal percentage markup, markup of competitive products attributable costs, and percentage of revenues.”<sup>13</sup> At that time, the Commission did not adopt any of these approaches. *Id.* Instead, the Commission adopted an alternative of basing competitive products contribution on a percentage of total institutional costs. *Id.* In adopting this approach, the Commission found that this percentage method “better reflects the section 3633(a)(3) directive and is more easily understood than the various alternatives.” *Id.*

In quantifying this approach, the Commission started with 6.9 percent of institutional costs, the maximum contribution attainable based on the rates it recommended in Docket No. R2006-1. Because the appropriate share represents a minimum contribution level, several other factors influenced the Commission’s decision to set the appropriate share at 5.5 percent. These factors include: (1) the fact that the PAEA “so thoroughly overhauls the ratemaking process” that the changes in that process should be taken into account; (2) rates for competitive products are no longer predicated on consideration of non-cost factors as they were under the Postal Reorganization Act (PRA), Pub. L. 91-375 (1970); and (3) under the PAEA, the Postal Service may retain earnings, so it has an incentive to exceed the threshold set by the Commission “including reducing rate pressure on market dominant rates, continuation of universal service, and the possibility of bonuses.” *Id.* ¶ 3053-56. The Commission also considered the risks inherent in setting the appropriate share. Setting it too high could hinder the Postal Service’s flexibility to compete especially since its market share was relatively small. *Id.* ¶ 3058. Setting it too low could harm competition by giving the Postal Service an artificial competitive advantage. *Id.* Accordingly, refraining from adopting a particular methodology, the Commission found that 5.5 percent was the appropriate share, at least initially, because the Postal Service “is no longer subject to the pricing constraints of the PRA[] [and] the Postal Service should perform at least as well as it has historically.” *Id.* ¶ 3060.

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<sup>13</sup> See Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, at ¶ 3050, August 15, 2007 (Order No. 26).

## V. COMMISSION ANALYSIS

The Commission must by regulation ensure that the competitive products collectively cover what the Commission determines to be an appropriate share of the Postal Service's institutional costs. 39 U.S.C. 3633(a)(3). The Commission is required to review its appropriate share regulation at least every 5 years to determine if the contribution requirement should be "retained in its current form, modified, or eliminated." 39 U.S.C. 3633(b). In making such a determination, the Commission is required to consider "all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products." *Id.* Additionally, the Commission has authority to revise this appropriate share regulation when circumstances warrant. 39 U.S.C. 3633(a).

A primary function of the appropriate share requirement is to ensure a level playing field in the competitive marketplace. The Postal Service's competitors incur certain fixed operating costs. If the Postal Service's competitive products were provided by a stand-alone enterprise, it too would incur fixed operating costs. The appropriate share requirement could be said to represent the fixed costs of the competitive enterprise and should reflect the ways in which institutional resources are spent on the competitive enterprise. If the Postal Service's competitive products were not required to contribute an appropriate share towards the institutional costs of the enterprise, this could result in the market dominant products cross-subsidizing the fixed costs of the stand-alone competitive enterprise. For this reason, the appropriate share requirement is an important safeguard to ensure fair competition on the part of the Postal Service.

In this section, the Commission analyzes "all relevant circumstances" that could affect its decision to retain, modify, or eliminate the current appropriate share contribution level under 3633(b). First, the Commission reviews the statutorily required relevant circumstances. Second, the Commission considers those relevant circumstances raised by the parties. Subsequently, the Commission discusses its

findings related to the appropriate share contribution level as well as other relevant findings.

A. Statutorily Required Considerations

Section 3633(b) explicitly requires the Commission to take into consideration the “prevailing conditions in the market” in determining whether to retain, modify, or eliminate the appropriate share contribution level for competitive products. 39 U.S.C. 3633(b).<sup>14</sup> In this case, the Commission reviews three prevailing conditions in the market that are relevant to its appropriate share analysis. First, the Commission considers whether there is evidence suggesting the Postal Service has benefited from a competitive advantage with respect to its competitive products. Next, the Commission considers the changes to the Postal Service’s market share with respect to competitive products between 2007 and 2011. Finally, the Commission considers changes to the market and to the Postal Service’s competitors.

1. Evidence of a Postal Service Competitive Advantage

In considering whether the Postal Service has a competitive advantage, the Commission reviews a report issued by the Federal Trade Commission (FTC) identifying “the federal and State laws that apply differently to the United States Postal Service with respect to the competitive category of mail and to private companies providing similar products.”<sup>15</sup> This FTC Report was mandated by the PAEA and was issued in December 2007. *Id.*; PAEA section 703. As such, it was unavailable during the Commission’s initial review of the appropriate share. The FTC Report finds that in

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<sup>14</sup> Section 3633(b) also explicitly requires the Commission to consider as a relevant circumstance “the degree to which any costs are uniquely or disproportionately associated with any competitive products” as part of its review of the appropriate share level. 39 U.S.C. 3633(b). As part of its review in this docket, no party has argued that such costs exist and the Commission does not independently find any uniquely or disproportionately associated competitive product costs that should affect the appropriate share of institutional costs contribution level for competitive products at this time.

<sup>15</sup> Accounting For Laws that Apply Differently to the United States Postal Service and its Private Competitors, Federal Trade Commission Report, at 1, December 2007 (FTC Report).

spite of any implicit subsidies afforded to competitive products from the Postal Service's status as a Federal government entity, Federally-imposed restraints on the Postal Service's operations increase its costs to provide competitive products and leave the Postal Service at a net competitive disadvantage. FTC Report at 64-67.

In addition to the FTC Report, the Commission considers whether there is any evidence of predatory pricing, an indication of competitive advantage, on the part of the Postal Service. First, it is important to note that the PAEA has a safeguard in place to mitigate the ability of the Postal Service to engage in predatory pricing. In order for predatory pricing to occur, the Postal Service has to price its competitive services below their marginal cost. However, 39 U.S.C. 3633(a)(2) requires each competitive product cover its attributable costs, thereby minimizing the Postal Service's ability to engage in predatory pricing at the product level. Second, as the Postal Service points out, none of its competitors have raised a complaint that the Postal Service has engaged in predatory pricing of its competitive products. Postal Service Comments at 7 n.8. In fact, only one major competitor, UPS, filed comments in this docket, and neither UPS nor any other commenter alleges that the Postal Service is predatorily pricing its competitive products or that it benefits from a competitive advantage in the competitive marketplace.

The appropriate share can also be viewed as imposing another level of protection against unfair or anti-competitive pricing on the part of the Postal Service. Competitors must produce revenues that cover both variable and fixed costs. In effect, the appropriate share assigns a portion of the Postal Service's fixed costs to competitive products collectively, so that the Postal Service, like its competitors, must set prices to produce sufficient revenues to cover both variable and fixed costs in their entirety. Thus, the appropriate share provides another way of leveling the playing field for competitive products. Because the Postal Service's revenues produced a contribution in FY 2011 that exceeded the 5.5 percent requirement, it appears that the current appropriate share provided another level of protection for competitors of the Postal Service.

Finally, the Commission notes that one of the PAEA's reforms was to make most of the United States' antitrust laws applicable to the Postal Service. See 39 U.S.C. 409(e). The relevant federal antitrust agencies as well as private parties are now able to bring lawsuits against the Postal Service for predatory pricing and other antitrust violations. The Commission is not aware of any such antitrust-related action having been taken against the Postal Service since the initial appropriate share determination.

The lack of evidence showing that the Postal Service has an advantage over its competitors with respect to competitive products supports a conclusion that the appropriate share requirement of a 5.5 percent minimum is not too low.

## 2. The Postal Service's Market Share

Another important aspect of the prevailing market conditions under 39 U.S.C. 3633(b) is the Postal Service's market share. In connection with this docket, the Postal Service submitted a summary of a market share analysis that it commissioned to show its market share in several important competitive markets since the Commission's initial appropriate share review in 2007. The following graphs are based on the data submitted by the Postal Service.<sup>16</sup> In Figure 1, the data are shown separately for domestic overnight air service and for domestic 2/3 day air and ground service. The graphs show the trend in volumes and revenues from FY 2007 to FY 2011.

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<sup>16</sup> See Notice of the United States Postal Service of Filing of Public Library Reference, April 13, 2012.

**Figure 1**  
**Postal Service's Market Share**



Both graphs in Figure 1 demonstrate that the Postal Service's market share for Domestic Overnight Air Packages and Domestic 2/3 Day Air and Ground Packages have steadily hovered around 4 percent and 16.5 percent respectively. With regard to

the overnight air delivery market, the Postal Service asserts that “the Postal Service lost volume share but increased its revenue share, demonstrating that it did not at all engage in the sort of predatory underpricing that section 3633(a)(3) is intended to prevent.” Postal Service Comments at 6-7. Similarly, the Postal Service contends that because the changes in market share for the combined domestic 2/3 day air and ground delivery market are small, it implies that the Postal Service does not enjoy an artificial advantage over its competitors. *Id.* at 7.

While an increasing market share would not directly imply that the Postal Service benefitted from an artificial competitive advantage, the Commission agrees with the Postal Service that the lack of a significant increase in market share minimizes concerns that the Postal Service may have an artificial advantage over its competitors.

### 3. Changes to the Market and Competitors

As part of the Commission’s review of the prevailing competitive conditions in the market, the Commission considers changes to the market and to competitors. First, the package delivery market is expected to expand in the coming years.<sup>17</sup> The Boston Consulting Group forecasted an increase of approximately 40 percent in package volume growth, an additional 1 billion pieces, between 2009 and 2020, driven by overall growth in business-to-consumer e-commerce. BCG Report at 10. Second, a significant competitor has left the market during the last 5 years. Prior to 2009, DHL Express was a competitor in domestic air and ground shipping services within the United States. In May 2008, DHL announced that it would be restructuring its United States network and in November of 2008, it announced that it would be effectively ending its domestic ground and air operations within the United States as of January 30, 2009.<sup>18</sup> By one

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<sup>17</sup> See, e.g., Projecting U.S. Mail Volumes to 2020, Boston Consulting Group, at 10, March 2, 2010, (BCG Report); Package Delivery Growth: Audit Report, Office of Inspector General, United States Postal Service, Report Number MS-AR-12-003, at 1, May 4, 2012; see also PR Comments at 2-3.

<sup>18</sup> DHL Presentation, “Restructuring of DHL US Express”, May 28, 2008, located at [http://www.dpdhl.com/content/dam/dpdhl/investoren/en/investoren/publikationen/archiv/2008/presentationen/dpwn\\_presentation\\_2008\\_05\\_en.pdf](http://www.dpdhl.com/content/dam/dpdhl/investoren/en/investoren/publikationen/archiv/2008/presentationen/dpwn_presentation_2008_05_en.pdf); DHL Press Release “Deutsche Post World Net takes strong action to reduce

estimate, DHL Express previously controlled 3 to 4 percent of the market share for domestic ground and air shipping within the United States.<sup>19</sup>

This market change provided the Postal Service an opportunity to expand its competitive services. However, during this period of potential expansion, the Postal Service continued to price in a way that allowed it to produce a contribution to institutional costs that exceeded the 5.5 percent requirement. Thus, the Commission does not find that these changed circumstances will provide the Postal Service with an unfair competitive advantage or should have an effect on the appropriate share contribution requirement.

## B. Considerations Raised by Commenters

The comments and reply comments filed by interested parties in this proceeding can be arranged into three different relevant considerations. First, the Commission reviews commenter considerations related to historical competitive contributions to institutional costs since the Commission's initial appropriate share determination. Second, the Commission considers the issues raised by commenters regarding changes to the competitive product offerings and associated changes in the mail mix. Finally, the Commission considers the issue raised by commenters relating to uncertainties.

### 1. Contribution Levels Over the Past 5 Years

The Public Representative, PSA, and the Postal Service each highlight the Postal Service's historical contribution levels since the initial appropriate share

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U.S. Express loss, improve Group performance in light of economic downturn," November 10, 2008, located at [http://www.dhl.com/en/press/releases/releases\\_2008/other/101108.html](http://www.dhl.com/en/press/releases/releases_2008/other/101108.html). Limited domestic service is still available from DHL, provided that the packages are tendered to the Postal Service for local delivery.

<sup>19</sup> CNN Money, "DHL to cut 9,500 U.S. jobs: The Firm Will End Deliveries Within the U.S., But Will Continue Shipments to Other Countries," November 10, 2008 located at <http://money.cnn.com/2008/11/10/news/companies/dhl/index.htm>.

determination.<sup>20</sup> The Commission agrees that it is reasonable to examine the contribution to institutional costs made by competitive products during the past 5 years as part of its appropriate share review analysis.

**Table 1**  
**Competitive Products Contribution<sup>21</sup>**

<b>Fiscal Year</b>	<b>Revenue in Excess of Attributable Cost (000)</b>	<b>Percentage Share of Institutional Costs</b>
2007	\$1,785,870	5.66%
2008	\$1,781,891	5.54%
2009	\$1,960,646	6.78%*
2010	\$2,420,224	7.12%
2011	\$2,309,938	7.82%*
*Without deferment of required prefunding of the RHBF, the percent share for FY 2009 and FY 2011 would have been 5.9 percent and 6.6 percent, respectively.		

As shown in the table above, the percentage share of institutional cost has been at least 5.54 percent with a high of 7.82 percent in FY 2011. Without Congressional legislation deferring the required prefunding of the RHBF payments due in FY 2009 and

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<sup>20</sup> PR Comments at 1; PSA Comments at 4; Postal Service Comments at 5.

<sup>21</sup> UPS points out in its comments that the competitive revenue in excess of the mandated appropriate share and the imputed tax does not automatically go toward institutional costs. See UPS Comments at 4 n.3; see also UPS Reply Comments at 2-3. Instead, for the past 5 years, competitive products have effectively contributed 5.5 percent of institutional costs plus imputed tax revenues. Response to CHIR No. 1 at 1; see also e.g., Competitive Products Income FY 2011, January 13, 2012. Accordingly, this table shows competitive revenue in excess of competitive products' attributable cost as a share of institutional cost.

FY 2011, the percentages for those years would have been approximately 1 percentage point lower. As Table 1 demonstrates, this percentage has increased steadily over time with the exception of FY 2008. In dollar terms, the competitive contribution increased by 29 percent since FY 2007. As such, it appears the initial contribution share requirement of 5.5 percent of the Postal Service's institutional costs has not hampered the Postal Service in pricing its competitive products.

## 2. Changes to Competitive Product Offerings and Mail Mix

The Postal Service, PSA, UPS, and the Public Representative believe that it is important for the Commission to consider changes to the Postal Service's competitive product list that have occurred since establishing the initial appropriate share determination.<sup>22</sup> Indeed, in Order No. 26, the Commission noted that changes to the competitive product list may be reason to modify the appropriate share requirement. Order No. 26 at ¶ 3061. As a related issue, PSA argues that significant and ongoing changes in the mail mix are arithmetically related to the relative contribution share of market dominant and competitive products. PSA Comments at 6.

To begin, the Commission highlights two of the major changes that have taken place since establishing the initial appropriate share contribution requirement.<sup>23</sup> In Docket No. MC2011-22, the Commission approved the transfer of commercial First-Class Mail parcels to the competitive product list.<sup>24</sup> This newly transferred competitive product, named First-Class Package Service, was effective as of October 1, 2011. Additionally, in Docket No. MC2010-36, the Commission approved the transfer of

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<sup>22</sup> Postal Service Comments at 9; PSA Comments at 2-3; UPS Comments at 7; PR Comments at 3.

<sup>23</sup> Another potential significant change related to Parcel Post was recently conditionally approved by the Commission. See Docket No. MC2012-13, Order No. 1411, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012.

<sup>24</sup> Order No. 710, Order Adding Lightweight Commercial Parcels to the Competitive Product List, April 6, 2011.

Commercial Standard Mail Parcels to the competitive product list.<sup>25</sup> Before the transfer, commercial Standard Mail Parcels were part of the market dominant product Standard Mail NFM/Parcels. In moving to the competitive product list, the former commercial Standard Mail Parcels offerings became a new “lightweight” subcategory of the Parcel Select competitive product. As a result of these transfers, total competitive revenue and volume have increased by 55.8 percent and 21.4 percent respectively to date over the prior year.<sup>26</sup>

Looking at the Commission’s prior Annual Compliance Determinations (ACDs) from 2007 to 2011, the volumes of competitive products as a whole relative to the Postal Service’s total volumes have been relatively constant. Competitive products’ volume represented 0.8 percent of total volume from 2007 to 2010 and 0.9 percent of total volume in 2011.<sup>27</sup> However, the recent transfer of commercial First-Class Mail parcels and commercial Standard Mail Parcels will increase the percentage share of total volume that competitive products represent. Based on preliminary data for the second quarter of FY 2012,<sup>28</sup> the competitive products volume now represents 1.6 percent of total volume.<sup>29</sup>

Whether an expansion of the Postal Service’s competitive products comes from competitive product transfers or volume growth is not by itself related to the appropriate

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<sup>25</sup> Order No. 689, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011.

<sup>26</sup> See USPS Preliminary Financial Information (Unaudited), June, 2012, August 13, 2012 at 2.

<sup>27</sup> See Docket No. ACR2007, Library Reference PRC-ACR2007-LR1 - FY 2007 Postal Service’s Finances, March 27, 2008; Docket No. ACR2008, Library Reference PRC-ACR2008-LR1 - FY 2008 Postal Service’s Finances, March 30, 2009; Docket No. ACR2009, Library Reference PRC-ACR2009-LR1 - FY 2009 Postal Service’s Finances, March 29, 2010; Docket No. ACR2010, Library Reference PRC-ACR2010-LR1 - FY 2010 Postal Service’s Finances, March 29, 2011; Docket No. ACR2011, Library Reference PRC-ACR2011-LR1 - FY 2011 Postal Service’s Finances, March 28, 2012.

<sup>28</sup> The full impact of the transfers to the competitive product list on total competitive volumes will not be fully understood until additional volume data becomes available. At this time, the volume data reflecting the transfers are preliminary and do not represent a full fiscal year.

<sup>29</sup> See Revenue, Pieces, and Weight (RPW) Report, Quarter 2, FY 2012, May 15, 2012.

share requirement. By definition, institutional costs do not vary with volume and are jointly shared by both the market dominant and competitive products.

However, if competitive volumes substantially increase relative to market dominant volume, under the right circumstances, the Commission could consider changing the appropriate share contribution level. This issue was not raised by the parties and at this time, the Commission does not find the current appropriate share requirement inaccurately reflects the proportion of institutional costs that should be borne by competitive products.

### 3. Uncertainties

PSA and the Public Representative argue that current uncertainties strongly support retaining the current 5.5 percent appropriate share contribution level.<sup>30</sup> For example, the Postal Service's proposal to change its overnight delivery standards and its mail processing network in Docket No. N2012-1 and its proposal to restructure its retail network in Docket No. N2012-2 could have a significant impact on the Postal Service's institutional costs. At the time of this proceeding, both dockets are currently pending before the Commission.

There is also uncertainty regarding the Postal Service's financial condition. In the most recent quarter of FY 2012, the Postal Service reported a loss of \$5.2 billion, \$2 billion more than during the same period in FY 2011. See Postal Service Form 10-Q Report for Quarter Three, Fiscal Year 2012, August 9, 2012. Such performance is unsustainable in the long term. As pointed out by several of the parties, this financial uncertainty has been an impetus for recent legislative activity, some of which could have an impact on the institutional costs of the Postal Service.

Taken together, the Commission recognizes that resolution of these uncertainties has the potential to alter the relationship of attributable costs to institutional costs.

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<sup>30</sup> See PSA Comments at 1-3; PR Comments at 3-5.

These uncertainties could affect the appropriate share contribution requirement in the future.

### C. Findings Regarding the Appropriate Share Contribution Level

The Commission's review includes consideration of the following relevant circumstances: the lack of evidence of a Postal Service competitive advantage; the market share analysis; changes to the market and competitors; historical competitive contribution levels; changes to competitive product offerings and the mail mix; and uncertainties. Taken together, the totality of these relevant considerations support a conclusion that retaining the current appropriate share contribution level is appropriate at the current time.

In making this determination, the Commission notes that the statute allows it to initiate a proceeding to change the competitive contribution's appropriate share at any time. Parties may also petition the Commission to initiate such a proceeding when circumstances warrant. Thus, if any of the significant uncertainties discussed above or by the parties materialize and result in meaningful changes to the Postal Service finances as it pertains to the section 3633(b), the Commission will be in a position to evaluate the effects of such changes on the appropriate share contribution level.

The Commission does not find it appropriate to adopt the Postal Service's proposal to grant itself the authority to find, on a case-by-case basis, that competitive contributions to institutional costs below 5.5 percent meet the appropriate share requirement based on prevailing circumstances. Postal Service Comments at 1, 3, 9-10. Section 3633(a) requires the Commission to set the appropriate share through "regulations." 39 U.S.C. 3633(a). Changing the appropriate share contribution level, even temporarily through another type of proceeding such as the Commission's ACD is more adjudicatory in nature than the general rulemaking proceeding suggested by the statute. Second, in addition to more closely following the text and intent of the statute, a rulemaking proceeding affords interested parties with a better opportunity for

participation than in the annual compliance process or another Commission adjudicatory-type proceeding.

The Commission also does not find changing the appropriate share methodology as advocated by UPS at the current time to be prudent. UPS did not propose a specific, concrete new methodology for the Commission and interested parties to review. This makes consideration of its proposed alternative challenging. Similarly, the Commission does not find it appropriate to eliminate the appropriate share contribution as Miller advocates. While the statute does anticipate possible elimination of the appropriate share contribution level at some point, the Commission does not believe that now is the proper time to do so.

The appropriate share requirement is one of the PAEA's principal protections against the Postal Service engaging in unfair or anticompetitive pricing. It effectively assigns a portion of the Postal Service's fixed costs to competitive products collectively, so that the Postal Service must cover those fixed costs to place it on a more level playing field with its competitors. The Commission will remain vigilant in its oversight of the Postal Service as to the requirement that it meet the appropriate share contribution level. If the Postal Service does not meet the required contribution level, the Commission will take all appropriate action to remedy the situation.

#### D. Other Findings

This docket has also identified two additional important issues with respect to the Postal Service's actual competitive contributions to institutional costs. First, in previous ACDs, the Commission has reported certain audited figures for the competitive contributions toward institutional costs.<sup>31</sup> These figures represented the competitive revenue in excess of competitive products' attributable cost as a share of institutional cost. Some confusion among participants in this case has resulted about the

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<sup>31</sup> See, e.g., Docket No. ACR2011, Annual Compliance Determination, at 163-64, March 28, 2012.

competitive contribution levels. See, *e.g.*, PR Comments at 2-3. In particular, the distinction between competitive products' contribution to institutional cost and the share of that contribution that is transferred to the Postal Service has been unclear. To avoid this and similar confusion in the future, as part of its next ACD, the Commission will consider how to best report the appropriate share contribution level to promote transparency and accountability of the Postal Service's competitive product finances.

Second, the Postal Service asserts that under 39 U.S.C. 2011(a)(2), it can "use the Competitive Products Fund to prepay competitive products' shares of future years' institutional costs...[and] pay for capital improvements that benefit competitive products." Response to CHIR No. 1 at 2-3. Section 2011(a)(2) clearly allows the Postal Service to pay for capital improvements that benefit competitive products. However, section 3633(a)(3)'s appropriate share requirement places a limit on section 2011(a)(2)'s broad scope. In particular, the Commission's section 3633(a)(3) appropriate share implementing regulation requires the Postal Service to contribute such appropriate share "annually, on a fiscal year basis." See 39 CFR 3015.7(c). Thus, the revenues from competitive products rates must, in each fiscal year, satisfy the requirements of 3633(a)(3). The Postal Service may not use funds from a prior fiscal year to satisfy this obligation.

## VI. CONCLUSION

For the reasons discussed above, the Commission finds that, under 39 U.S.C. 3633(b), the appropriate share contribution for competitive products should be retained in its current form at this time.

VII. ORDERING PARAGRAPH

*It is ordered:*

For the reasons set forth in the body of this Order, pursuant to 39 U.S.C. 3633(b), the appropriate share regulation shall be retained in its current form.

By the Commission.

Shoshana M. Grove  
Secretary